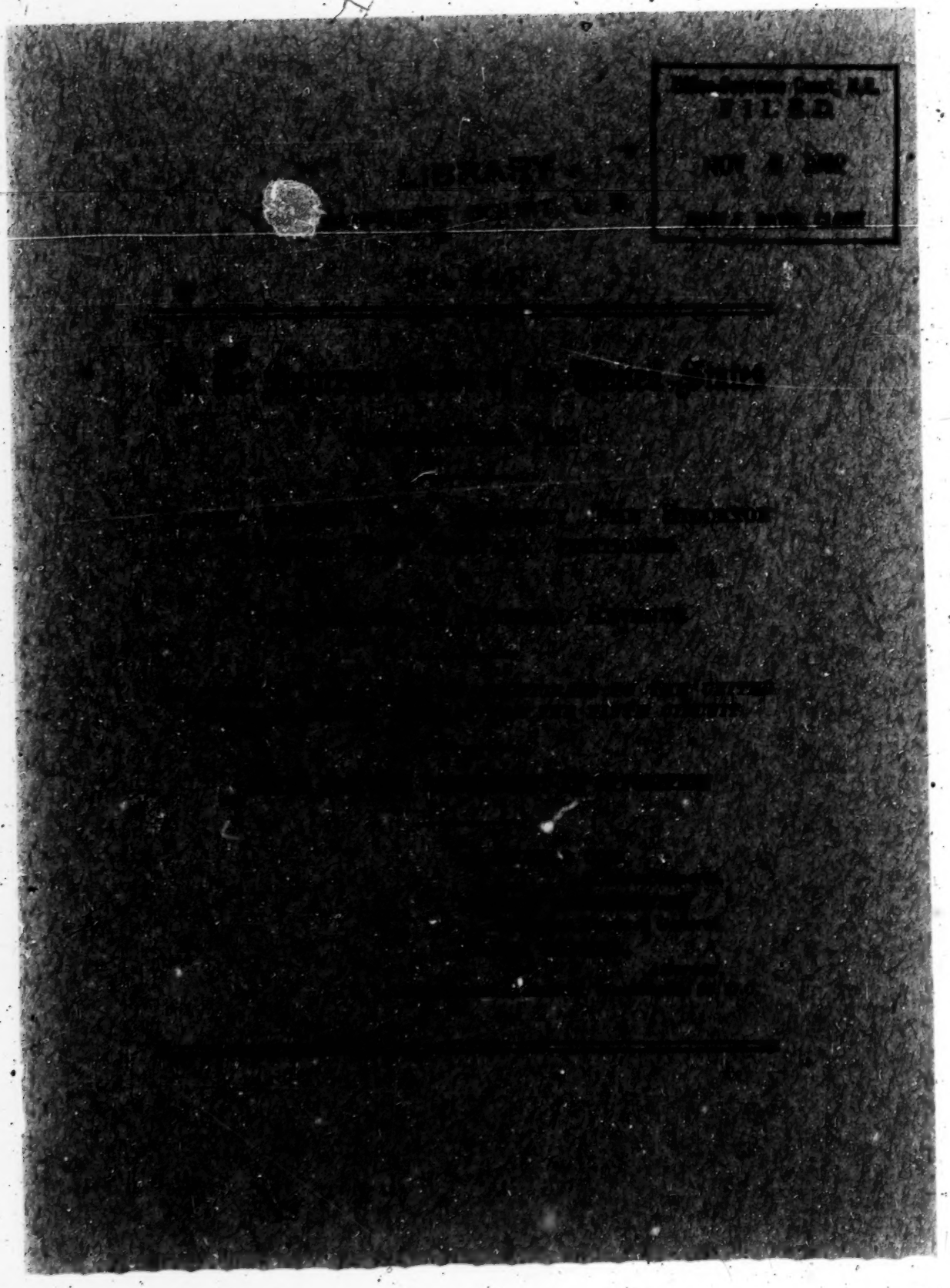

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Argument	5
Conclusion	10
Appendix	11

CITATIONS

Cases:

Bank of America National Trust & Savings Assn. v. *United States*, No. 270, certiorari denied October 15, 1962	9
Burk-Waggoner Assn. v. *Hopkins*, 269 U.S. 110	8
Evans v. *Superior Court*, 14 Cal. 2d 563, 96 P. 2d 107, appeal dismissed, 309 U.S. 640	8
Fahey v. *Mallonee*, 332 U.S. 245	8
Franklin Nat. Bank v. *New York*, 347 U.S. 373	9
Jackson Finance & Thrift Co. v. *Commissioner*, 260 F. 2d 578	9
Morgan v. *Commissioner*, 309 U.S. 78	8
Morris Plan Bank of New Haven v. *Smith*, 125 F. 2d 440	7, 8
Morris Plan Co. of California v. *Commissioner*, No. 534	3
Oulton v. *Savings Institution*, 17 Wall. 109	7
Peoples Finance & Thrift Co., In re, 61 Cal. App. 2d 11; 141 P. 2d 742	8

665050—62——1

Cases—Continued

	Page
Richardson v. *Superior Court*, 138 Cal. App. 389, 32 P. 2d 405	8
Staunton Industrial L. Corp. v. *Commissioner*, 120 F. 2d 930	7, 8
Trede v. *Superior Court*, 21 Cal. 2d 630, 134 P. 2d 745	8
United States v. *City Loan and Savings Co.*, 287 F. 2d 612	9
United States v. *Pelzer*, 312 U.S. 399	8
Statutes:	
California Financial Code, 30 West's Annotated California Codes, Division 7	2, 4
Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):	
Sec. 104(a)	2, 11
Sec. 436	2, 11–12
Sec. 437	2, 5, 12–13
Sec. 439	2, 5, 13
Miscellaneous:	
McKenna, *Control and Management of Federal Savings and Loan Associations*, 27 S. Cal. L. Rev. 47 (1953)	9
Treasury Regulations 130, Sec. 40.439–1	2, 5, 14

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 447

VALLEY MORRIS PLAN, FORMERLY THE STOCKTON MORRIS PLAN COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1–44), with opinion on denial of taxpayer's petition for rehearing (Pet. App. 46–48), is reported at 305 F. 2d 610. The findings of fact and opinion of the Tax Court (R. 11–26) are reported at 33 T.C. 572.

JURISDICTION

The judgment of the Court of Appeals was entered on May 22, 1962. (R. 147; Pet. App. 45.) Taxpayer's petition for rehearing was denied on June 29, 1962. (R. 148; Pet. App. 46–48.) The petition for a writ of certiorari was filed on September 20, 1962. The juris-

diction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the indebtedness of a Morris Plan company evidenced by thrift certificates was allowable as borrowed capital in computing its excess profits tax credit under the Excess Profits Tax Act of 1950.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of Sections 104(a), 436, 437 and 439 of the Internal Revenue Code of 1939, and of Treasury Regulations 130, Section 40.439–1, are printed in the Appendix, *infra,* pp. 11–14.

STATEMENT

The essential facts, based upon a stipulation (R. 6–10) and the testimony of taxpayer's president, E. B. Fuld (R. 39–65), are not in dispute, and are set forth in the Tax Court's findings (R. 11–20). They can be summarized as follows:

The tax years involved are the excess profits tax years 1951, 1952 and 1953. The taxpayer was organized under the California Industrial Loan Act (California Financial Code, 30 West's Annotated California Codes, Division 7). Taxpayer is engaged in the business of making small loans and purchasing paper, notes, conditional sales contracts and other evidence of indebtedness. (R. 19.) Taxpayer derives most of the funds used in its business from the issuance of term and installment thrift certificates.[1]

[1] Its capital stock was $100,000 in 1951 and 1952 and $200,000 in 1953. (R. 12.) The average daily balances of the tax-

The term certificates are issued in $500 and $1,000 denominations. They pay interest at 4%, or 1% more than the rate paid on savings accounts by commercial banks, if held to the three-year maturity or longer, but can be redeemed at lower rates at any time, subject to a requirement of 30 days notice which has never been invoked. (R. 11–13, 15–18.) The term thrift certificates are issued for cash at taxpayer's place of business, are non-negotiable, and carry no rights to participate in management. About 73% were held beyond maturity. Installment thrift certificates have no maturity, carry a lower interest rate, and may be added to from time to time. (R. 13–14.)[2]

---

payer's indebtedness on bank loans, term thrift certificates and installment thrift certificates were as follows (R. 14):

	Year 1951	Year 1952	Year 1953
Bank loans	$68,698.63	$25,204.92	$14,178.08
Term thrift certificates	271,169.96	558,662.57	780,300.27
Installment thrift certificates	1,572,456.78	1,939,761.93	2,318,630.20

[2] Here the term thrift certificates, if includable in taxpayer's borrowed capital, would be sufficient to relieve it of any excess profits tax, without regard to the includability of the installment thrift certificates. In the companion case of *Morris Plan Co. of California* v. *Commissioner*, No. 534, which was heard and decided by the court of appeals together with the present case and is also pending on petition for writ of certiorari, installment thrift certificates are the main basis for the taxpayer's claim. It there appears that installment certificates can be added to in multiples of $1, and in 1951, 1952 and 1953, bore interest at 2%, 2½% and 3%. Whereas, the term certificates are single sheets, the installment certificates are issued in passbook form. Both carry in large letters the legend "THIS IS NOT A CERTIFICATE OF DEPOSIT", and in all other respects are the same.

Taxpayer's business is regulated and supervised by the California Department of Investment, Division of Corporations. (R. 18–19, 46.) It must apply for permission to issue a stated amount of thrift certificates on specified terms, furnishing complete financial data. (R. 12.) All of the taxpayer's advertising, which refers to its certificates as "accounts", is supervised by the Division of Corporations. The regulations governing its loans impose stringent limitations on the interest rate, the term and the security. It must file detailed annual reports with the Division, including a financial statement and an analysis of surplus. (R. 18–19.) In addition, it is subject to at least an annual audit, and were it conducting its affairs in an unsafe or injurious manner, the Commissioner of Corporations might take possession and liquidate it in the same manner as a bank. California Financial Code, 30 West's Annotated California Codes, Division 7, Sections 18804, 18815–18820. It is, however, prohibited by law from referring to itself as a bank or to its certificates as bank deposits.

Taxpayer is in competition with other industrial loan companies, small loan companies, personal property brokers, credit unions, finance companies, banks, pawn brokers and others. It has never attempted to become a member of the Federal Reserve System, believing it could not qualify, and was denied insurance by the Federal Deposit Insurance Corporation on the ground that it did not come within the definition of a bank under that Act. (R. 19.) Taxpayer is a member of the Morris Plan Bankers Association, of the American Bankers Association, and of the Consumer Bankers Association. (R. 20.)

On these facts, the Tax Court held the taxpayer was not a bank, and that its term thrift certificates were not certificates of deposit but instruments having the general character of invesment securities issued by a corporation, within the meaning of Treasury Regulations 130, Section 40.439–1, Appendix, *infra*, p. 14. (R. 22.) The court of appeals reversed, holding that the taxpayer was a bank within the commercial and dictionary meaning of the term, as well as the Revenue Code definition of a bank, found in Section 104 (a), Appendix, *infra*, p. 11, and that the certificates were plainly certificates of deposit in a bank, created in the same way and used for the same purposes as bank deposits.

ARGUMENT

Under the Excess Profits Tax Act of 1950, the excess profits "credit"—*i.e.*, the base figure deemed to represent normal profits—is based on invested capital, which consists of two principal components: "equity capital" and "75 per centum of the average borrowed capital for the taxable year . . ." Section 437(2) (A) and (C). Section 439 defines "average borrowed capital" as the aggregate of the "daily borrowed capital" for each day of the taxable year, divided by the number of days in that year. It then provides, in subsection (b), that "daily borrowed capital" shall be the sum of the "amount of the outstanding indebtedness . . . of the taxpayer, incurred in good faith for the purposes of the business, which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness . . ." Section 40.439–1(f) of the Treasury Regulations

issued under the Act, the validity of which is here conceded, defines a certificate of indebtedness to include "only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals," but to exclude from borrowed capital "indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit * * *." The question presented by this case is whether the indebtedness of the petitioner here, evidenced by thrift certificates, falls within the scope of includable borrowed capital as defined by the Act and the Regulations, or whether it falls within the scope of excludable bank deposits. Although the decision below admittedly conflicts in principle with the decisions of two other circuits, we submit that it is clearly correct, and that, in any event, the issue presented is not one which warrants review by this Court.

1. On the undisputed facts, taxpayer is plainly engaged in the banking business. Its business consists primarily of receiving deposits and making loans and discounts, under strict State regulation akin to the regulation of banks. As the court below stated (Pet. App. 19), "Banks engage in the same business * * * that the respondent is engaged in and they use depositors' money for the same purposes respondent uses the money derived from the sale of thrift certificates." Hence, as the court concluded (Pet. App. 21–39), a Morris Plan company would be treated as a bank

for income tax purposes under Section 104(a) of the Internal Revenue Code of 1939, Appendix, *infra*, p. 14, the dictionary definitions, and the classic definition of a bank. *Staunton Industrial L. Corp.* v. *Commissioner*, 120 F. 2d 930 (C.A. 4th); *Morris Plan Bank of New Haven* v. *Smith*, 125 F. 2d 440 (C.A. 2d); *Oulton* v. *Savings Institution*, 17 Wall. 109.[4]

It is most significant that at no point in its petition does the taxpayer controvert the basic fact that it functions in all essential respects just as a bank functions and that the State supervises and regulates it in the same manner as it regulates banks. The most that the taxpayer can claim is (1) that it is not a general bank, entitled to Federal Deposit Insurance or membership in the Federal Reserve System, and (2) that under State law it is not called a bank or regulated by

[4] In *Oulton* the Court said (p. 118–119):

> Banks in the commercial sense are of three kinds, to wit: 1, of deposit; 2, of discount; 3, of circulation. Strictly speaking the term bank implies a place for the deposit of money, as that is the most obvious purpose of such an institution. Originally the business of banking consisted only in receiving deposits, such as bullion, plate, and the like, for safe-keeping until the depositor should see fit to draw it out for use, but the business, in the progress of events, was extended, and bankers assumed to discount bills and notes and to loan money upon mortgage, pawn, or other security, and at a still later period to issue notes of their own intended as a circulating currency and a medium of exchange instead of gold and silver. Modern bankers frequently exercise any two or even all three of those functions, but it is still true that an institution prohibited from exercising any more than one of those functions is a bank in the strictest commercial sense * * *.

the Superintendent of Banks. But neither of these points is well taken. As the *Staunton* opinion noted (p. 934), there are many types of special banks, such as savings banks, mortgage or home loan banks, long-term agricultural land banks, short-term cooperative and intermediate agricultural credit banks. Taxpayer is a consumer credit bank engaged in the small loan, personal banking business, but it is nevertheless a bank and the funds placed with it by the public in the form of thrift certificates are bank deposits in all but name.

It is unimportant that State law does not accord the name bank or bank deposits to the taxpayer and its accounts, or that the taxpayer is supervised and examined by the Commissioner of Corporations, rather than the Bank Superintendent. As *Morris Plan Bank of New Haven* said (p. 441), "names are not what control. * * * Realities do." It is settled that the revenue laws, taxing banks or other specified entities or persons, are to be given a uniform interpretation. *United States* v. *Pelzer*, 312 U.S. 399; *Morgan* v. *Commissioner*, 309 U.S. 78; *Burk-Waggoner Assn.* v. *Hopkins*, 269 U.S. 110.[4]

[4] Indeed, in substance the State law here recognizes that its regulation of industrial loan companies is the same as that provided for banks. *In re Peoples Finance & Thrift Co.*, 61 Cal. App. 2d 11, 141 P. 2d 742. See also *Evans* v. *Superior Court*, 14 Cal. 2d 563, 96 P. 2d 107, appeal dismissed, 309 U.S. 640; *Trede* v. *Superior Court*, 21 Cal. 2d 630, 134 P. 2d 745; *Richardson* v. *Superior Court*, 138 Cal. App. 339, 32 P. 2d 405; cf. *Fahey* v. *Mallonee*, 332 U.S. 245, 250. The restrictions upon the use by a Morris Plan company of the name of "bank" and of "deposits" may be nothing more than an effort by banks to restrict Morris Plan companies in their competition for savings,

The taxpayer's remaining arguments on the merits have little weight. The question presented is not, as taxpayer contends (Pet. 11–12), one of fact, conclusively determined by the findings of the Tax Court, but, rather, one of law as to what are the legal characteristics of a bank and bank deposits.[5] This is apparent from taxpayer's effort to put the Revenue Code, dictionary, and commercial definition of a bank to one side. Despite taxpayer's claim (Pet. 13–16), this issue was squarely raised and decided by the Tax Court, which held (R. 22) that taxpayer was not a bank and its certificates were not bank deposits.

2. We acknowledge that the decision below conflicts in principle with decisions of the Tenth Circuit in *Jackson Finance and Thrift Co.* v. *Commissioner*, 260 F. 2d 578, and the Sixth Circuit in *United States* v. *City Loan and Savings Co.*, 287 F. 2d 612. Despite this conflict, however, we submit that the present case does not warrant review by this Court. The issue presented here has very little continuing significance. Cf. *Bank of America National Trust and Savings Association* v. *United States*, No. 270, certiorari de-

---

and are not to be seriously regarded by federal law, especially since the restrictions are not effective. See McKenna, *Control and Management of Federal Savings and Loan Associations*, 27 S. Cal. L. Rev. 47 (1953). See also *Franklin Nat. Bank* v. *New York*, 347 U.S. 373.

[5] The statement of the Tax Court (R. 25) that the purchasers of taxpayer's term thrift certificates obviously intended to make a loan, an investment, is conclusory. As the opinion below points out, the only facts in the record are the objective descriptions of the taxpayer's business, the term of the certificates, the way they are issued, held and retired, and the state regulations, all of which describe a bank and bank deposits.

nied, October 15, 1962. The last taxable year to which the 1950 Excess Profits Tax Act applied was 1953. The instant case involves $23,785.30, and No. 534 involves $267,000. The taxpayer in No. 534, Morris Plan Company of California, has another claim of $89,000. The only other pending cases of which we are aware[6] involve a total of $446,000.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
LOUIS F. OBERDORFER,
Assistant Attorney General.
JOSEPH KOVNER,
Attorney.

NOVEMBER 1962.

[6] There are eleven such pending cases.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C. 1952 ed):

CHAPTER 1—INCOME TAX

* * * * *

SUBCHAPTER C—SUPPLEMENTAL PROVISIONS

* * * * *

SEC. 104 [as amended by Sec. 313(h), Revenue Act of 1951, c. 521, 65 Stat. 452]. BANKS AND TRUST COMPANIES.

(a) *Definition.*—As used in this section the term "bank" means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, 38 Stat. 262 (U.S.C., Title 12, Sec. 248(k), as amended, and which is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions. Such term also means a domestic building and loan association.

* * * * *

SUBCHAPTER D—EXCESS PROFITS TAX

* * * * *

SEC. 436 [as added by Sec. 101, Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137]. EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL.

(a) *General Rule.*—In the case of a domestic corporation (except a corporation described in subsection (b)) the excess profits credit for any taxable year computed under this section shall be the sum of the following:

(1) The invested capital credit computed under section 437, reduced by the amount computed under section 440(b) (relating to inadmissible assets), and

* * * * * *

SEC. 437 [as added by Sec. 101, Excess Profits Tax Act of 1950, *supra*]. INVESTED CAPITAL CREDIT.

* * * * * *

(b) *Invested Capital.*—

(1) *Election of Taxpayer.*—The invested capital for any taxable year shall be the adjusted invested capital determined under paragraph (2), except that if the taxpayer elects in its return for such taxable year to compute its invested capital under the provisions of section 458, the invested capital for such year shall be the historical invested capital determined under section 458. For the invested capital of certain insurance companies, see paragraph (3).

(2) *Adjusted Invested Capital.*—The adjusted invested capital for any taxable year (hereinafter in this paragraph referred to as "the taxable year") shall be the sum of—

(A) the equity capital (as defined in subsection (c)) as of the beginning of the taxable year;

(B) the capital addition for the taxable year computed under subsection (d);

(C) 75 per centum of the average borrowed capital for the taxable year computed under section 439(a); and

* * * * * *

SEC. 439 [as added by Sec. 101, Excess Profits Tax Act of 1950, *supra*]. BORROWED CAPITAL.

(a) *Average Borrowed Capital.*—For the purposes of this subchapter, the average borrowed capital for any taxable year shall be the aggregate of the daily borrowed capital for each day of such taxable year, divided by the number of days in such taxable year.

(b) *Daily Borrowed Capital.*—For the purposes of this subchapter, the daily borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:

(1) The amount of the outstanding indebtedness (not including interest) of the taxpayer, incurred in good faith for the purposes of the business, which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, deed of trust, bank loan agreement, or conditional sales contract. In the case of property of the taxpayer subject to a mortgage or other lien, the amount of indebtedness secured by such mortgage or lien shall be considered as an indebtedness of the taxpayer whether or not the taxpayer assumed or agreed to pay such indebtedness, plus

* * * * * *

Treasury Regulations 130, promulgated under the Internal Revenue Code of 1939:

SEC. 40.439–1. *Borrowed capital.* (a) The amount of the average borrowed capital of a corporation shall be computed in the manner provided in section 439(a) and the daily borrowed capital, as defined in sections 439(b)(1), (2), (3), and (4), shall be computed in the manner provided in section 439(b). The average borrowed capital for any taxable year is the aggregate of the daily borrowed capital for each day of the taxable year, divided by the number of days in such taxable year. * * *

* * * * * *

(f) The term "certificate of indebtedness" includes only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals. The term "conditional sales contract" means a contract corresponding to a mortgage except that the transfer of title is made dependent upon the payment of the stipulated price. Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check, and the term "bank loan agreement" does not include the indebtedness of a bank to a depositor.

U.S. GOVERNMENT PRINTING OFFICE:1962